JULY 1990
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Industrial Distribution

THE BUSINESS MAGAZINE FOR INDUSTRIAL DISTRIBUTORS

SPECIAL:

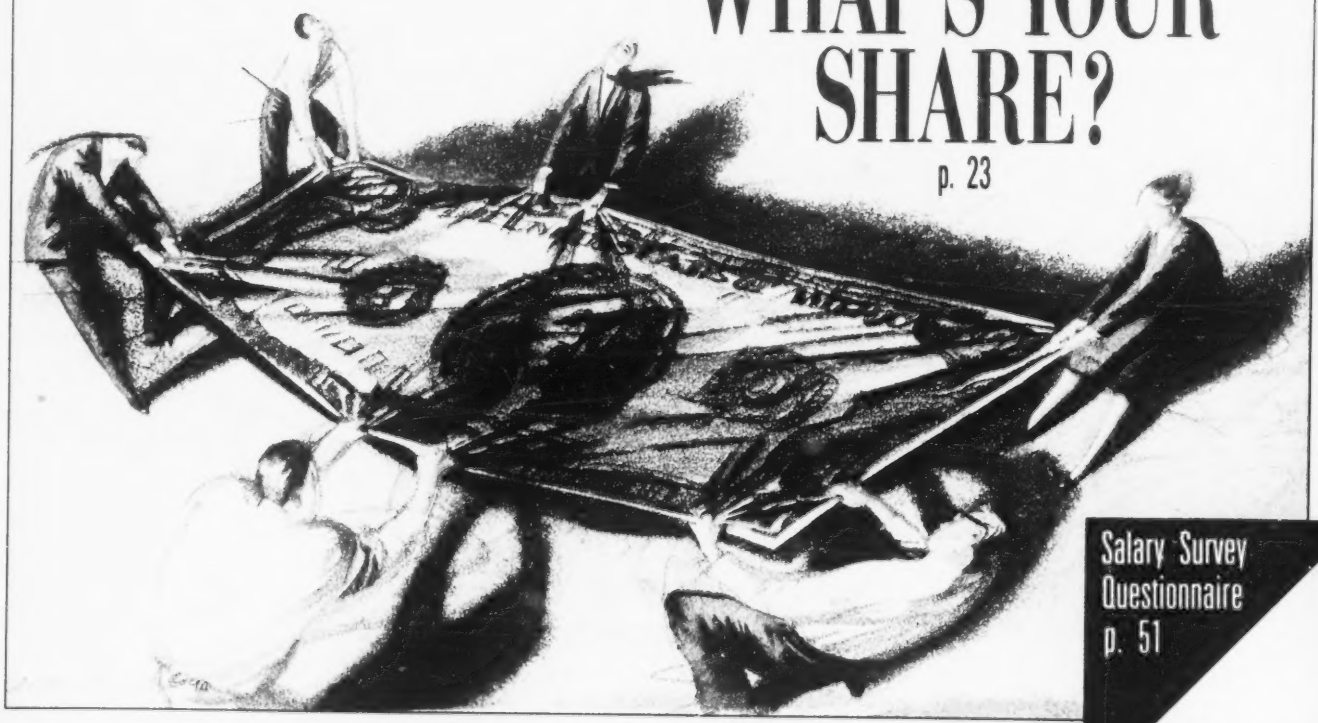
Upgrading cutting tool sales

EXCLUSIVE!

44th ANNUAL OPERATIONS SURVEY

WHAT'S YOUR SHARE?

p. 23



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Industrial Distribution

THE BUSINESS MAGAZINE FOR INDUSTRIAL DISTRIBUTORS

VOL. 79, NO. 7 JULY 1990 A CAHNERS PUBLICATION

Use our *Survey* results in comparing your firm to the industry as a whole.

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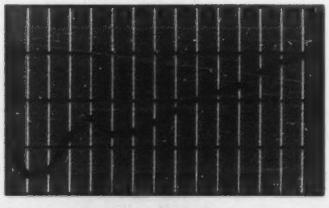

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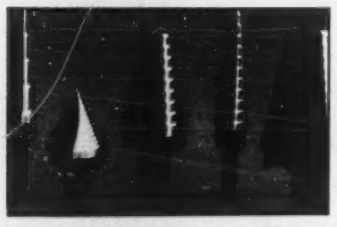

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Exclusive service for ID readers.

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NEWS

Garrett/Carboloy reach compromise

Garrett Industrial Supply and Carboloy Inc. discontinue longstanding relationship except for integrated supply accounts.

When Kennametal Inc. bought Garrett Industrial Supply last year, the big question industry experts posed concerned what would become of Garrett's status as a leading Carboloy distributor.

Most knowledgeable industry people wondered how a Kennametal-owned Garrett Industrial Supply could maintain an effective relationship with Carboloy, one of Kennametal's toughest competitors in the carbide cutting tool market (see chart).

That question was resolved earlier this year, when Garrett and Carboloy Inc. discontinued their longstanding relationship, except for Garrett's present and future integrated supply contracts.

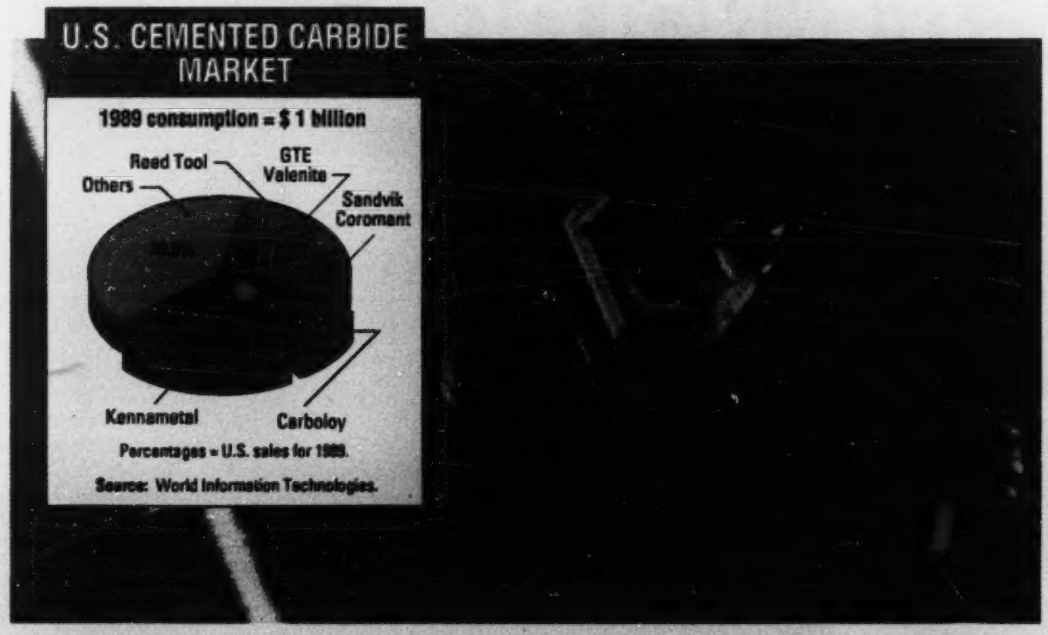
"We knew this would happen at some point," says Darryl Dillenback, vice president of operations for the Los Angeles-based distributorship. "As long as the Garrett/Carboloy question went unresolved, there was always going to be a cloud hovering over both our heads."

THE NEED TO COMPROMISE

Officials from both Garrett and Carboloy agree that the two companies made a fair compromise. The crux of the matter is that as part of its plan to become a national distributor, Garrett wanted Carboloy to support Garrett's new branches in the Cleveland, OH, Albany, NY and Boston, MA areas.

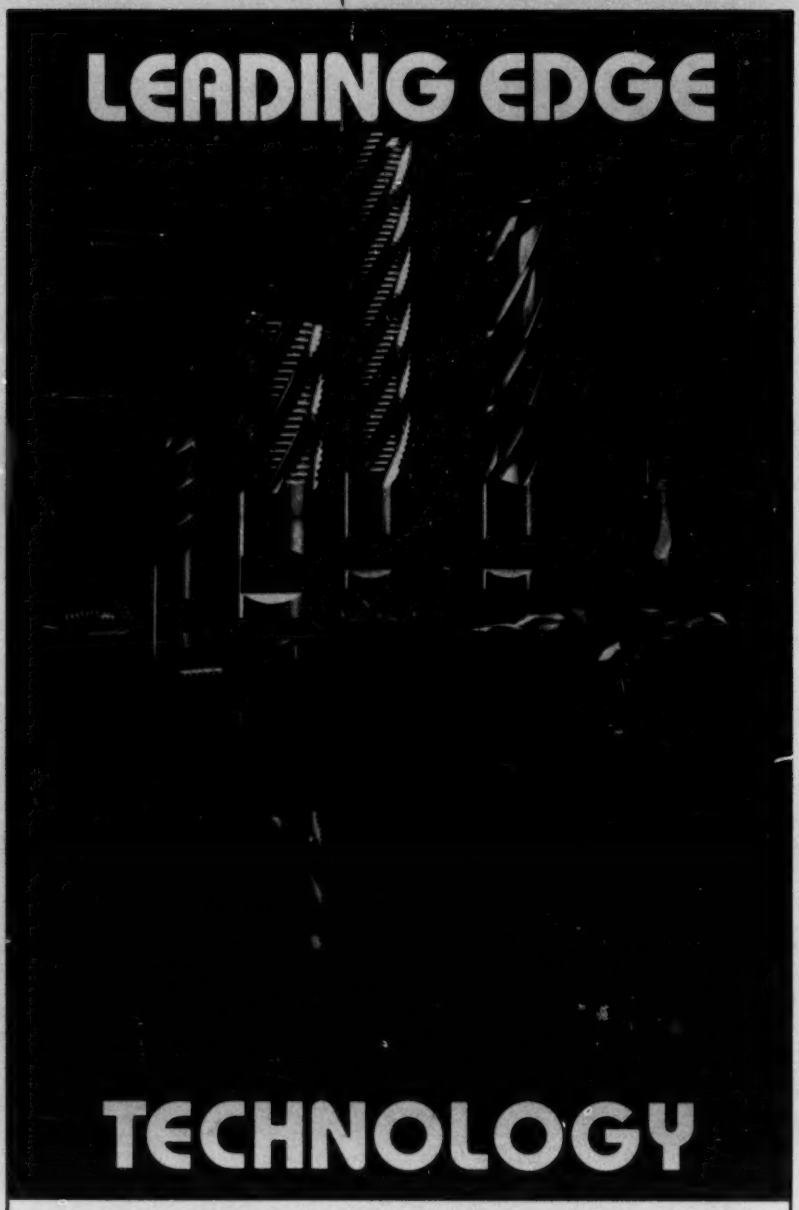
But John MacKenzie, Carboloy's manager of marketing services, says that Garrett, in effect, "asked us to authorize them for areas in which we felt we were fully covered. The plain fact is that we weren't prepared to compromise our existing distribution in those regions."

Under the terms of the verbal agreement, beginning June 30 the Carboloy line will be available to Garrett only for Garrett's integrated supply customers like General Electric, which awarded Garrett broad-based MRO contracts for several of



Kennametal, Carboloy and three other cutting tool suppliers captured about 60% of the U.S. cemented carbide market in 1989.

LEADING EDGE



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NEWS

its major U.S. divisions earlier this year.

According to Dillenback, the integrated supply contracts, for which Carboloy is one specified vendor, are for GE's Aircraft Engine Group facilities in Lynn, MA; Rutland, VT; Hooksett, NH; and Albuquerque, NM; as well as the firm's 13 Aerospace Operations Div. facilities throughout New York, New Jersey, Massachusetts, Pennsylvania, and Florida.

WHAT TO DO ABOUT THE CHAINS?

Carboloy's MacKenzie views this compromise as reflective of the tough choices industrial manufacturers will be faced with as the industry consolidates and the large distribution chains become more powerful.

"The way the marketplace is going, manufacturers have to be prepared to accommodate both the independents and the large chains," says MacKenzie. "I feel that, in the Garrett situation, we've done that pretty well."

While at this point it's unclear how successful Garrett will be at becoming a large chain, one thing is certain—Kennametal, which also purchased mail order house J&L Supply (Detroit, MI) earlier this year—has ambitious plans for Garrett Industrial Supply.

According to Dillenback, Kennametal hopes to transform Garrett from a nine-branch, regional distributorship with anticipated sales of $70 million in 1990 to a national concern with 35 branches, four regional hubs and $450 million in sales by 1996.

Kennametal's strategy for Garrett, says Dillenback, is to win an integrated supply contract, open a branch in the appropriate region and then service the surrounding local market. He says that as of January, Garrett has won $50 million worth of integrated supply contracts. Most are for three years, with two-year renewal options, he says.

Now that Garrett is no longer an authorized Carboloy distributor, the company says it will begin handling Kennametal products in all of its branch locations. The move is significant, because Kennametal traditionally approached the marketplace on a direct sales basis.

"Because of its direct sales policy, Kennametal was missing out on 50%

of the carbide marketplace," says Dillenback. "Taking on the Kennametal line is an exciting opportunity for us here at Garrett."

In early June, Garrett and Kennametal salespeople met to determine how to avoid duplication of effort in the field. According to Dillenback, some accounts will be sold through distribution, some direct and still others will be sold on a joint basis.

While Garrett and Kennametal decide on how to approach the market, Carboloy has plans of its own. Last year, Carboloy added two new distributors in the Los Angeles market, and recently signed on a new distributor in the Philadelphia area.

One of the new West Coast distributors, Slater Industrial Supply (Cerritos, CA), is excited about the prospect of vying for the Carboloy business formerly held by Garrett. "Sure, going up against Kennametal will be tough," says Slater's president Robert C. Skidmore. "But at stake is about $1.5 million in Carboloy sales that Garrett was doing in the Southern California market. That's a great opportunity for us." —*By Steve Zurier* □

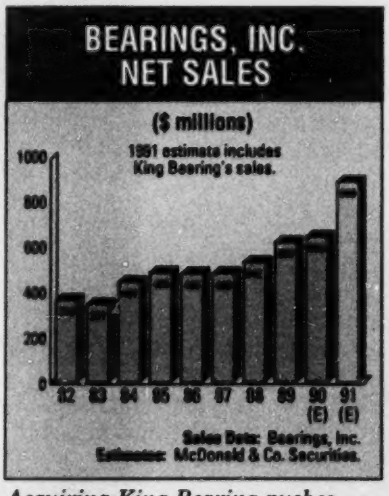
Bearings, Inc. slated to buy King Bearing

CLEVELAND, OH—Acquisition of King Bearing (Corona, CA) by Bearings, Inc. could form what may become the power transmission industry's first billion-dollar distributorship.

Analysts estimate that Cleveland-based Bearings, Inc. will add up to $200 million in sales by acquiring King Bearing (see chart). Bearings, Inc., already the largest bearings distributor with 269 branches in the U.S. and Puerto Rico, reported sales in excess of $630 million for the fiscal year ending June 30, 1989.

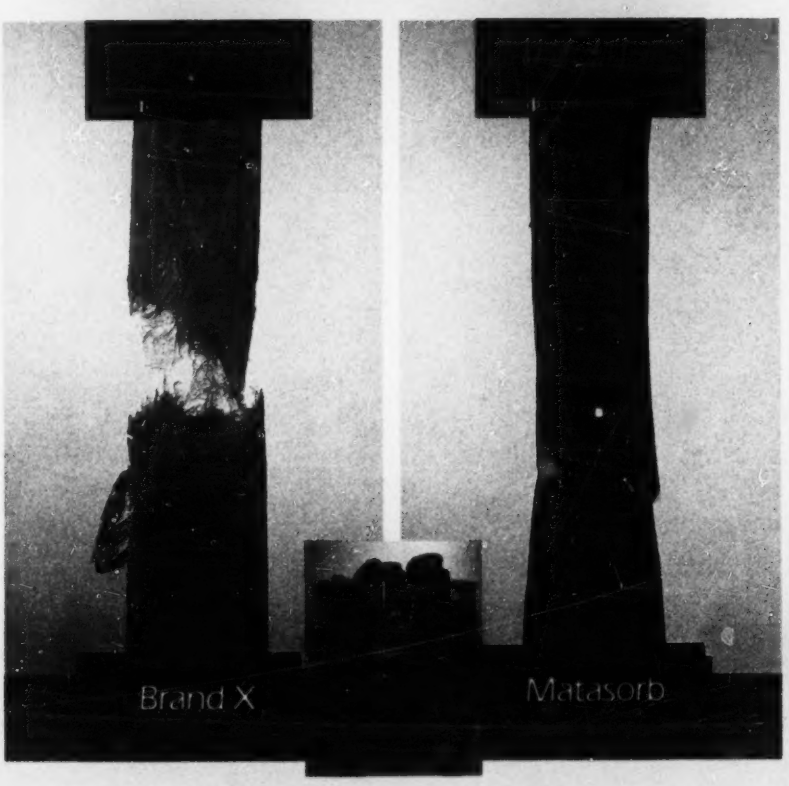
In May Bearings, Inc. announced plans to buy King Bearing from Emerson Electric Co. of St. Louis, MO. Emerson acquired King when it purchased French-based Leroy-Somer for $460 million late last year. The giant conglomerate wants to sell the distributorship to concentrate on its manufacturing operations.

Raymond E. Smiley, vice president, treasurer and chief financial officer of Bearings, Inc., said that the deal with Emerson Electric was expected to close by June 30. He said that King Bearing, which operates 94 branches in nine Western and



Acquiring King Bearing pushes Bearings, Inc. annual sales close to the $1 billion mark.

STRENGTH IN NUMBERS.



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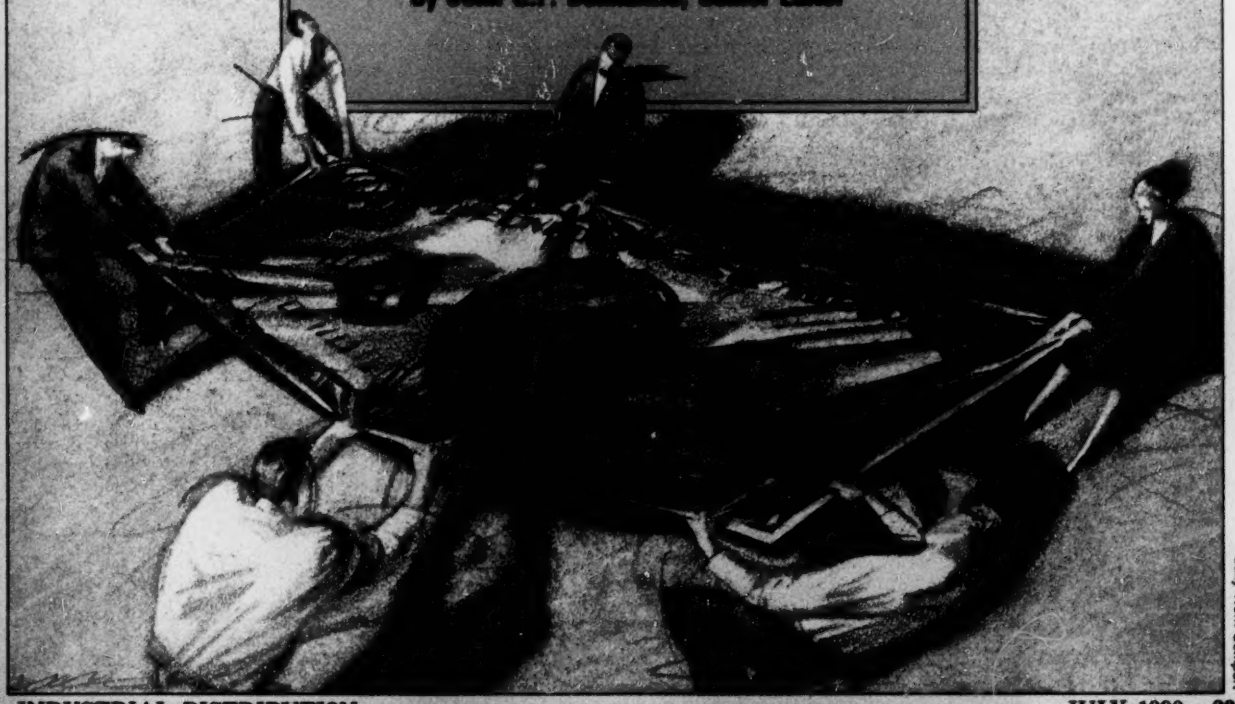
INDUSTRIAL DISTRIBUTION'S EXCLUSIVE SURVEY

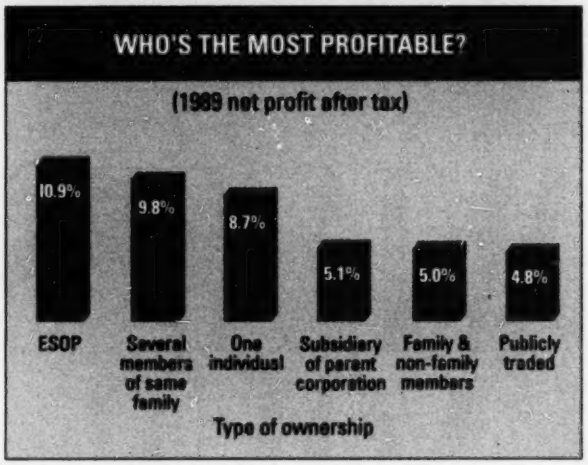
WHAT'S YOUR SHARE?

In 1989 distributors' sales rose, profit margins thinned, and manufacturing output held a steady course.

By John G.F. Bennasole, Senior Editor



Sally Wern Comport



For once, most economists were right. Last year the nation's economy held a steady course keeping well clear of most recessionary dangers. Unemployment stood still at 5.3%, overall capital spending rose 5%, and industrial distributors' sales reacted in kind by climbing 7.5%.

However, unexpected head winds in the form of inflation slowed real growth to a crawl; wholesale inventory stock climbed 4.2%; and distributors, like their manufacturing counterparts, tallied disappointing profits as fourth quarter losses appeared to diminish earlier gains as the year wound itself out.

When factoring 4.6% inflation into the price of finished goods, distributors' sales rose a paltry 2.9%. Contrast that to 1988 when revenues increased 9% and producer inflation was only 3.2%. What's left is real growth of 5.8%—exactly twice that of 1989's performance. While such news is no doubt a disappointment, in light of manufacturing's 3% increase in profits, the findings of *ID*'s *44th Annual Survey of Distributor Operations* can hardly be called surprising.

During 1989 the dollar's value overseas reversed its three year decline and gained back nearly 2% of its 1980 value (see chart below). This made American goods somewhat more expensive abroad thereby curbing offshore interest in American products and, sliced merchandise export growth in half. This, and a maturing economic expansion slowed industrial output at home from 5.4% in 1988 to 2.5% in 1989. The fallout from this was immediate, as distributors found it difficult to increase profits with the cost of inventory outpacing gains made in sales.

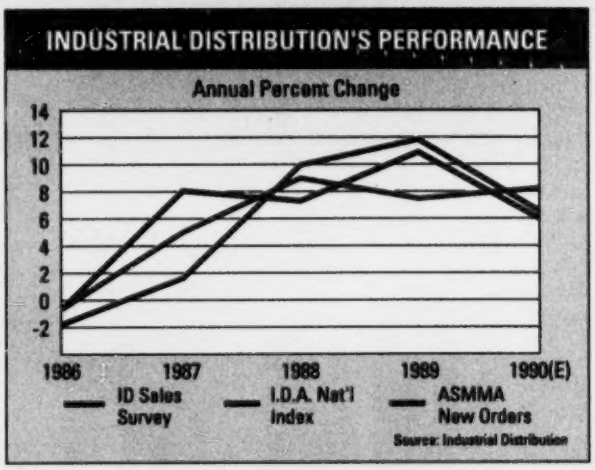
Industry-wide, distribution's cost of goods rose from 65.3% of sales in 1988 to 68.7% last year. At the same time, distributors' inventories increased by 8.6%, however, net profits before tax slid from 14.8% in 1988 to 12.2% in 1989. If there's any consolation in that news, MRO suppliers were not alone in feeling their margins squeezed. According to a *Business Week* survey of 900 public companies, sales increased 10% during 1989 while profits collapsed 19%. Among manufacturers of machine and hand tools the story was even more dramatic: sales were up 20% while profits headed south to the tune of 22%.

Back on the distributor side, sales and profits varied greatly by type of business (generalist versus specialist); from region to region; and, when measured against sales size (see map). By far the strongest section of the country was the West (+23%), which has led the rest of the nation in growth for two years running. Although California's economy has begun to slow (everything from housing starts to computer manufacturing have fallen-off), aerospace companies with big stakes in commercial rather than military projects are helping to keep the economy airborne. Despite a 45-day strike at Boeing, sales took off by 20% while its order backlog is worth a record $90 billion. In the Pacific Northwest, paper, pulp and forest products remain at such high capacity utilization levels (90+%), that double-digit sales increases were logged most notably by International Paper (+16%) and Louisiana-Pacific (+13%).

In America's industrial heartland, here called the North Central region, sales climbed 5.5%. But with car, truck, tire and vehicle parts production all sinking, the question is, "what kept the region afloat during 1989?" Surprisingly, the answer seems to be capital spending. Last year manufacturing invested 10% more in new plant and equipment than in 1988 and, according to a Dept. of Commerce anticipations survey, spending will increase another 4% in 1990.

What makes all of this so unusual are the contradictions found in the economy. Typically, when profits

collapse so severely, inventory stocks plummet, large-scale layoffs are initiated and capital spending declines. During 1989 none of this occurred. Instead, inventory stocks climbed 4.2%, manufacturing employment declined a relatively minor 2%, manufacturing's capacity utilization increased slightly to 84%, and capital spending seemed to keep industrial distributors busy with a steady stream of business. In fact, the American Supply and Machinery Manufacturers' Assn.'s New Order Index rose 11% in 1989, a performance which closely matched the 11.9% sales increase posted by members of the Industrial Distribution Assn.



On the heavy equipment side, John Deer's sales climbed 16%, and Caterpillar kept up its effort in keeping Japan's Komatsu Ltd. at bay by increasing sales 7%. One of the few laggards in the North Central region was raw steel production which declined 4%. This narrowed already razor-thin margins, and profits collapsed 25%.

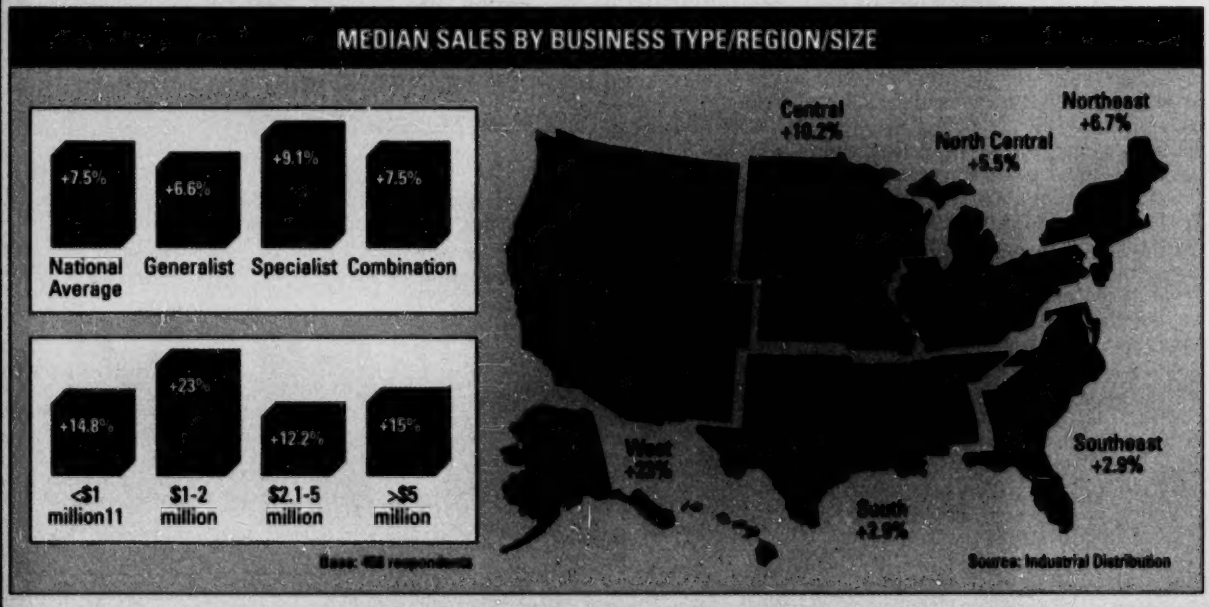
In the Northeast, the economy is being carefully watched as a harbinger of nation-wide recession, although its 6.7% sales growth suggests that 1989 wasn't so terrible after all. Or was it? Distributors with strong ties to the construction industry (those who sell specialty tools and fasteners), probably suffered the most. The Dept. of Labor indicates that every Northeast state (except Vermont) lost construction jobs between December 1988 and December 1989. No matter what the causes may have been—poor weather, overbuilding, rising mortgage rates or declining employment—the net effect was a 20% decline in housing starts which idled some 50,000 construction workers.

On the industrial side the picture was none better. Massachusetts lost 5% (or 28,000 jobs) of its manufacturing base, and Connecticut, despite having strong presences in aerospace and defense, laid-off 15,000 workers as well. If the 4.6% inflation is factored out of the expansion in Northeast distributor sales, all that's left is 2% real growth.

In the Central region, which contains fewer than 10% of the nation's manufacturing plants, rising grain exports buoyed distributor sales by 10.2%. But even the region's traditional manufacturing base fared well. In Minnesota, sales at Pentair, Inc. (whose out-of-state divisions produce Porter-Cable power tools and Delta woodworking machinery) climbed 41%, and 3M increased profits 8% on rising sales of 6%. Even the consumer market pitched-in to help. Iowa-based appliance manufacturer Maytag enjoyed a 64% upturn in business, while Whirlpool rang up increased sales of 42%.

With 2.9% sales increases, this year's regional underachievers were the South and Southeast. Supply business in the Southeast was affected by a slowdown in paper and paper products production, where capacity utilization rates dipped from a high of 95% in 1988 to 92.6%. Helping to offset this downturn, textile mill production remained strong, falling just short of 92% capacity utilization.

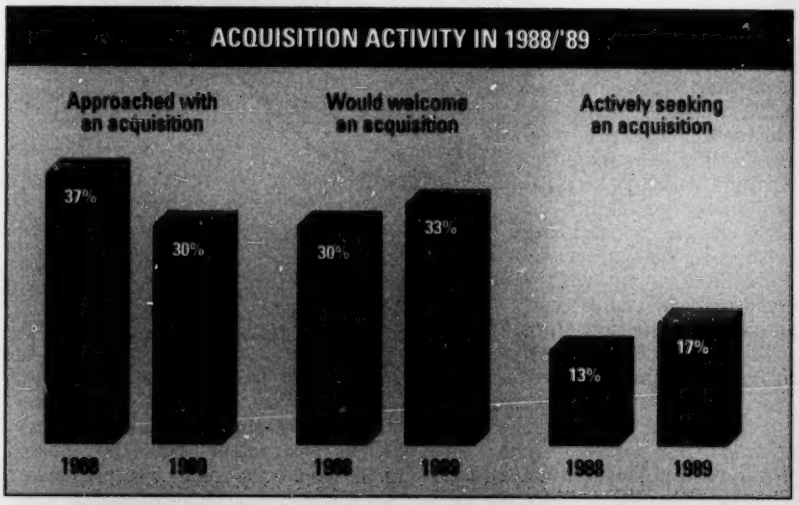
Looking to the South, distributors with their ears to the ground are hearing murmurs of activity in the oil patch. Horizontal and offshore drilling start-ups generate optimism but rising oil prices drive increased rig counts. Gulf Coast refineries are working at 87% capacity while chemical producers have increased capital expenditures 18%. Even if other industries have stalled, chemical processors are likely to keep distributors of pipes, valves and fittings busy well into the 1990s.

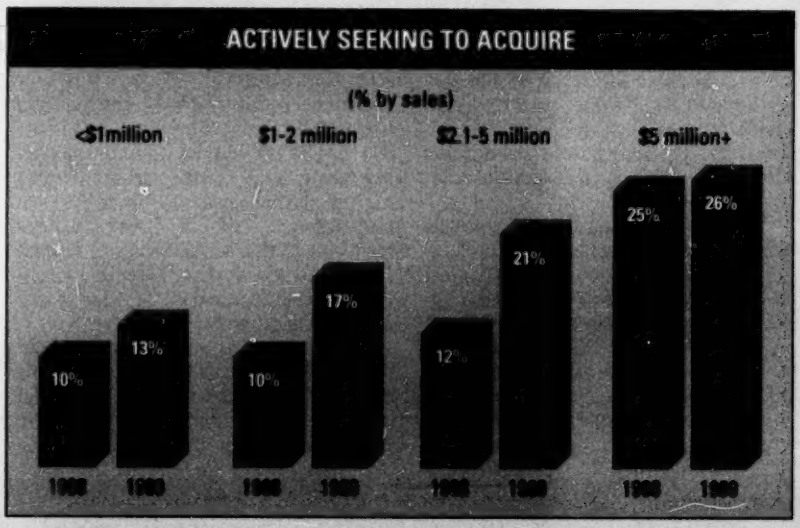


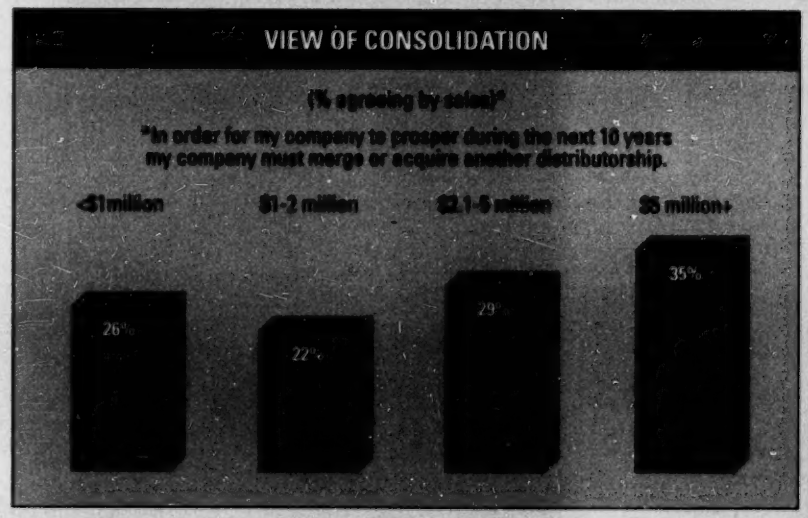
This year's *Survey* once again measures the industry's interest in mergers and acquisitions and, as usual, the data is again revealing. Although the number of companies approached with an acquisition offer has fallen from 37% in 1988 to 30% in 1989, a slighter higher percent say they would both welcome and are actively looking to acquire another distributorship.

Twenty-nine percent of general line houses said they would welcome an acquisition offer, 36% of specialists, and 37% of combination houses. But within these three categories, no one group was any more inclined to acquire, nor was any one distributor type more likely to be approached by an acquirer. When measured by sales size, however, the differences were dramatic. For obvious reasons, distributors with sales in excess of $5 million are twice as likely to acquire than those with sales below $1 million. And perhaps for fear of being squeezed out of the market, mid-sized distributors (those with sales between $2.1 million to $5 million), have become more active in the merger and acquisition game.

The distributor's long-term view of the industrial supply business is also shaped more by sales size than by type of business. Case in point: while 28% of all distributors agree with the statement that prosperity during the next 10 years will require merging or acquiring another distributorship, there was no difference in opinion when measured by type of firm. When viewed by sales, the differences were pronounced. Twenty-six percent of businesses with sales below $1 million agreed with that statement while 35% in the $5+ million range agreed. Conclusion? Whether there's truth in the saying that distribution will become an industry of very large and very small businesses is true or not, large industrial suppliers are taking this message to heart and the small distributor, perhaps incapable of reacting, are idly watching the drama play itself out.







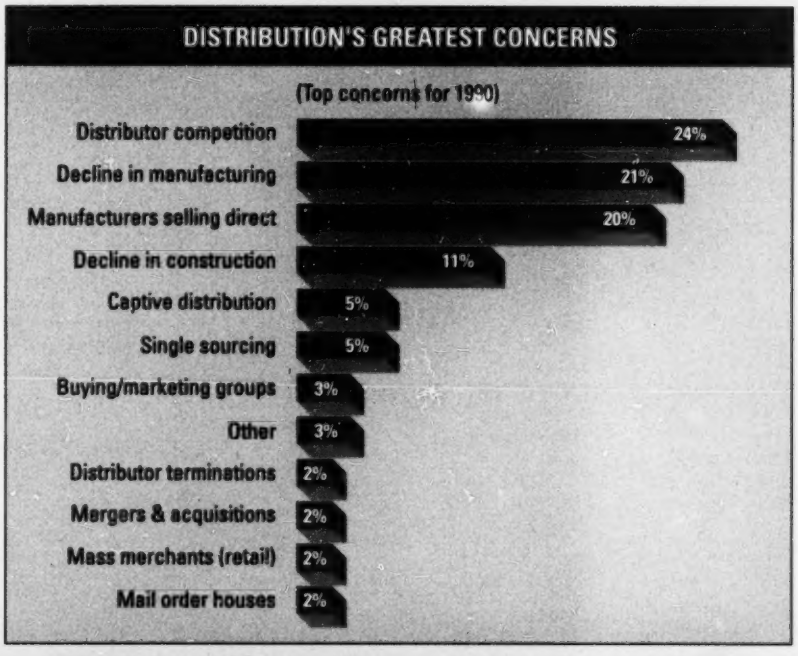
Source: Industrial Distribution

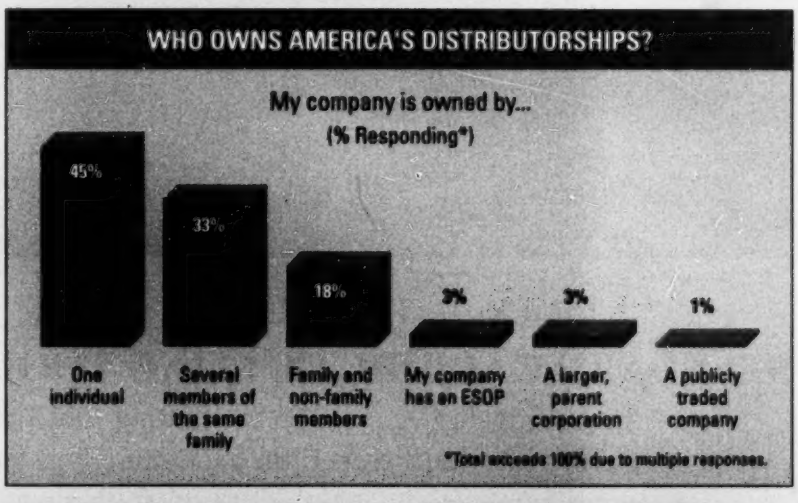
The old stereotype that industrial distributorships are today owned by individuals whose fathers first started the business shortly after the Second World War is a myth that won't fade easily. While there is some truth to this image, data from this year's *Survey* reveals that businesses with this kind of history are more the exception than the rule.

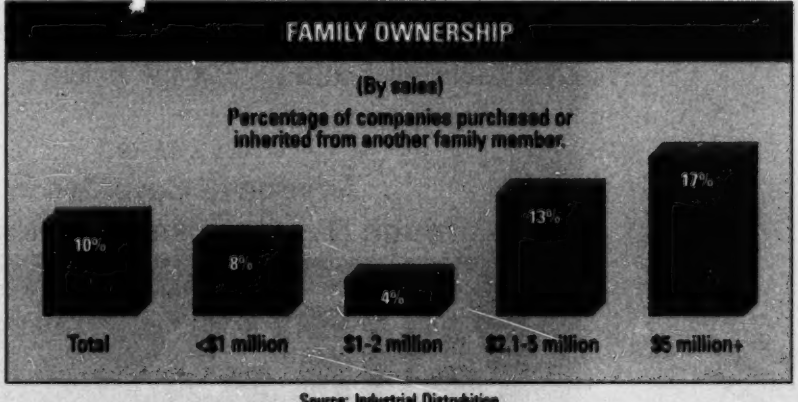
The average age of all industrial distributorships is 24 years; only 14% were started prior to 1945. In fact, nearly one-third of all firms are 10 years of age or less; more than half are 20 years old or less. There is also a relationship between sales and age. As a rule, the older the business the larger its sales. Distributorships with less than $1 million in sales average 18 years; $1- 2 million 20 years; $2.1-5 million 14 years; and $5+ million 33 years.

With respect to ownership, there are fewer surprises—distribution is still a family-run industry. Forty-five percent of respondents said that their companies are owned by only one individual; 33% by several members of the same family; and 18% by family and non-family members. Because of this concentration of ownership in the hands of relatively few, it's little wonder that only 3% of distributors have employee stock ownership plans (ESOPs). The relationship between type of ownership and profitability is discussed in "Sales & Profits."

And what worries America's family-owned distributorships the most? More than anything else, industrial supply houses are most concerned with the competition coming from other distributorships (24%). This is evident by price-slashing which inevitably leads to pressure on margins. Concern number two is the overall decline in manufacturing activity (21%), while 20% worry about manufacturers selling direct. Other trends which have been widely reported and discussed seem relatively inconsequential. From captive distribution to distributor terminations and mail order houses, suppliers are properly focused on those issues in which they have the least control.







Source: Industrial Distribution

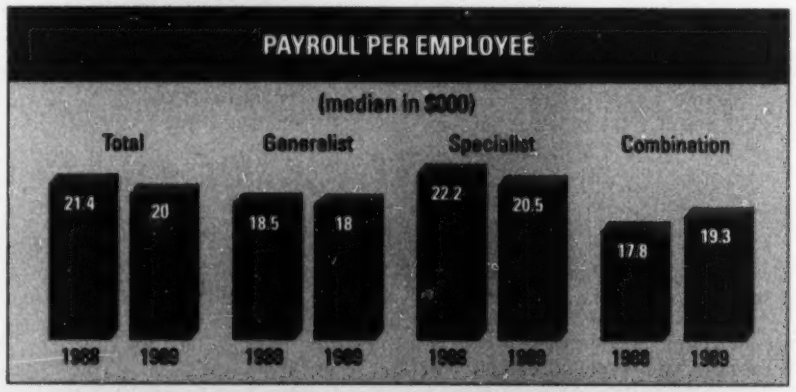
PERSONNEL

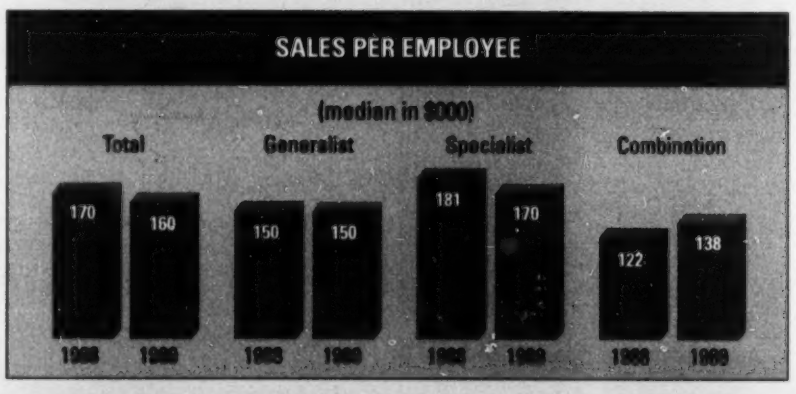
Like other areas of distributors' operations, the personnel picture is a decidedly good news/bad news scenario. First the good. Overall, payroll costs per employee appear to have dipped from a median of $21,400 in 1988 to $20,000 in 1989. (When measuring averages, however, costs climbed 5.2%—see "Operations.") This 7% drop would seem significant to the industry's bottom line but, unfortunately, is not easily understood when compared with *ID*'s 1989 Salary Survey data. In that report, compensation rose 10% leading to the obvious question: why such a discrepancy?

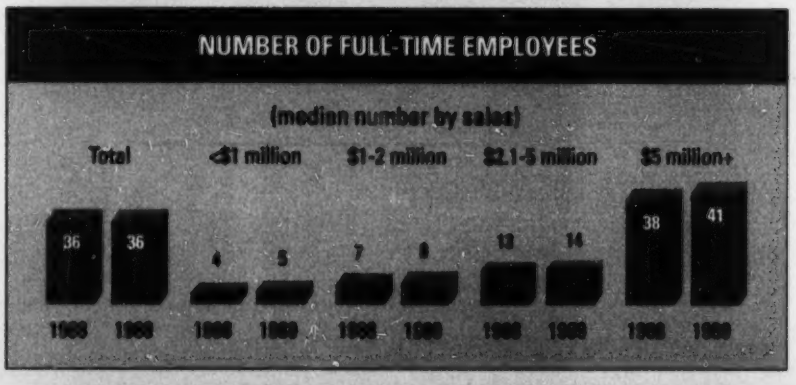
One reason is the different respondent base. While the Salary Survey (Nov. '89) focused primarily on management's wages where salary increases are twice as high for "executives" than for inside or counter salespeople, this year's operations *Survey* measures payroll for all job descriptions including part-time help. The resulting data indicates that while top distribution pay scales have outpaced inflation, warehouse and clerical staff have not fared as well.

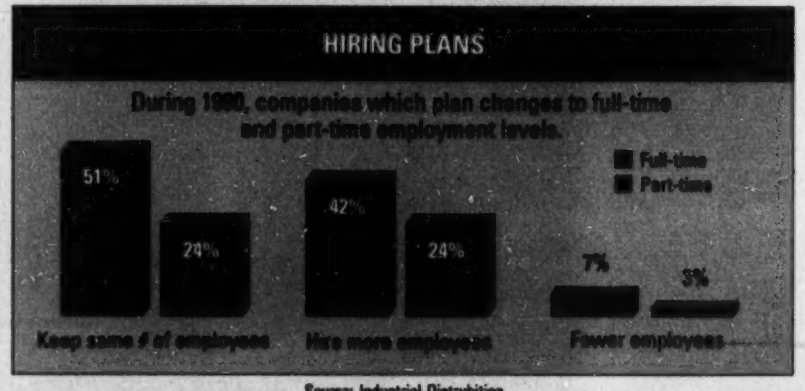
While distributors struggled to hold onto their existing full-time employees (there are no discernible employment changes between 1988 and 1989), the bad news is that sluggish sales pulled-down the sales-per-employee ratio by 6.25%. Whereas 1988's ratio stood at $170,000, last year it crept down to $160,000 with the same trend evident among generalists and specialists. On the other hand, combination houses hoisted their ratio 13% to $138,000 while their net profit (before tax) far outpaced that of the general line and specialty distributor.

As for hiring plans in 1990, half of all distributors speculate that they will keep payrolls steady; 42% think it likely to hire more full-timers; and only 7% expect their number of employees to decline. As for part-time help, 61% of distributors use them and of those, 32% are likely to hire more sometime this year. Similarly, 29% will keep part-time employment steady, and only 3% will reduce their payroll.









Source: Industrial Distrubition

OPERATIONS

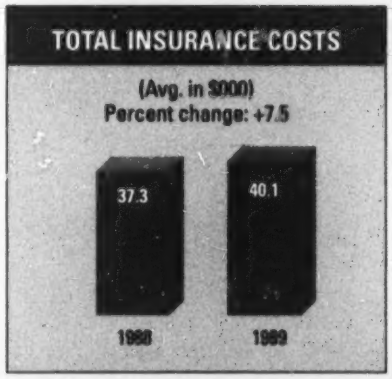
The costs incurred in running an industrial distributorship went up last year, and insurance is one of the reasons why. In 1988 total insurance expenditures averaged $37,300 and reached $40,100 last year. This 7.5% increase was not too bad in light of what happened to product liability insurance.

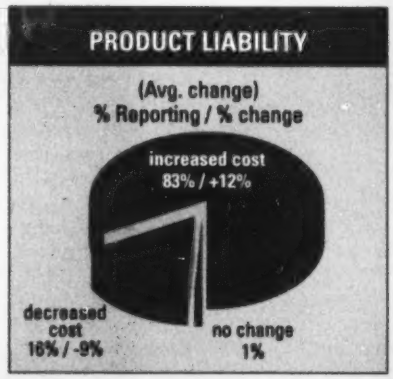
Eighty-three percent of distributors said that their product liability costs increased an average of 12%. For the 16% reporting a decline, costs dropped 9%. Using data from last year's *Survey*, that would put the median value of liability insurance at approximately $5,600. But a word of caution. First, that figure rises dramatically by sales size as well as by distributor type and region.

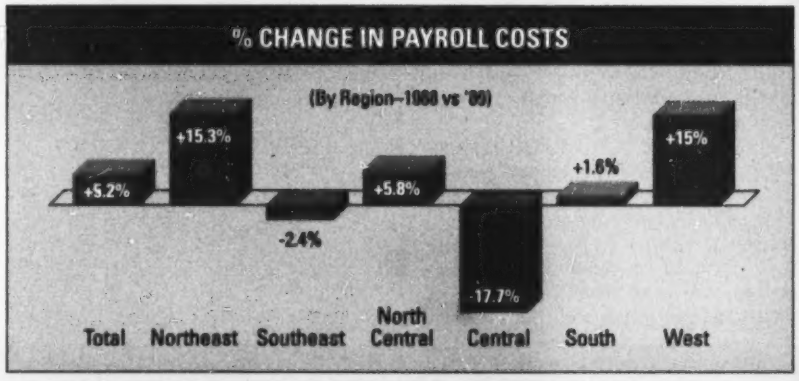
For example, distributors in Pennsylvania are often subject to higher liability costs as a result of how they might register their business with revenue collectors. Because the tax structure attempts to keep manufacturers in the state, it is generally less expensive to say that a business as a manufacturer, not a distributor. As a result, liability insurance is oftentimes inflated.

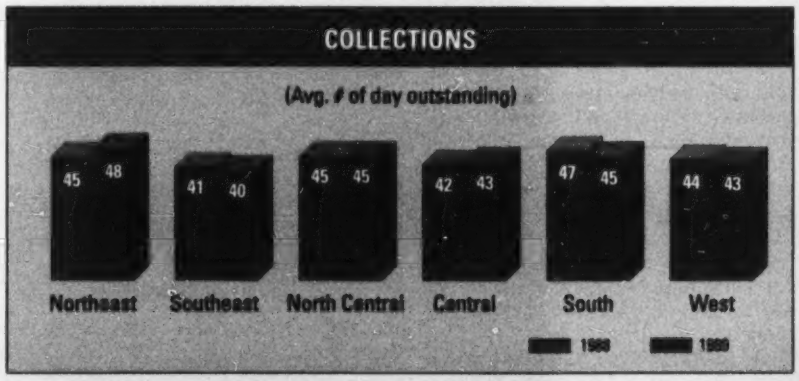
At the same time insurance costs rose, the average payroll increased as well. Nationally, employee's paychecks were 5.2% higher in 1989 than in 1988 (although median wages decreased—see "Personnel"). Interestingly, vast differences were found on a regional basis. In Central states where sales increases were 10.2%, overall payroll costs plummeted nearly 18%. Conversely, in Western states where sales shot-up 23%, total payroll costs were right behind having risen 15%.

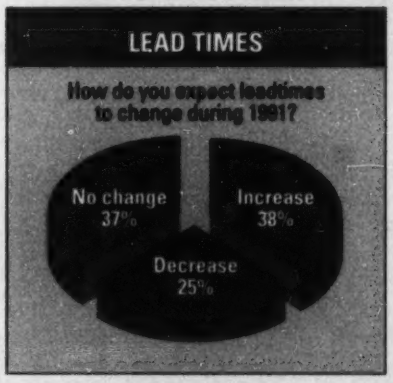
In terms of collections, regional differences were not as significant, unless you're a distributor in the Northeast. There the number of days collections were outstanding in 1989 was 48 compared to 40 in the Southeast. Nationally, the average is 44 days which is unchanged from one year earlier. As for leadtimes, 38% of distributors expect to wait longer for deliveries in 1990 than in 1989, 25% expect them to decrease, and 37% believe leadtimes will remain unchanged.

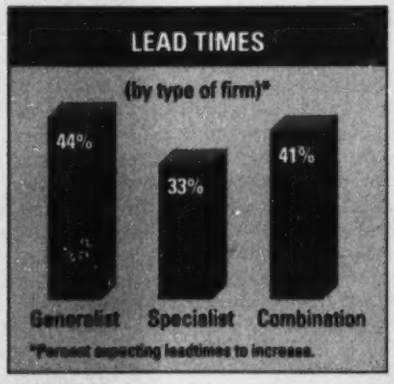






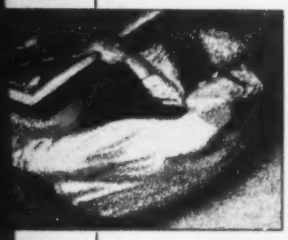






Source: Industrial Distribution

INVENTORY & RECEIVABLES

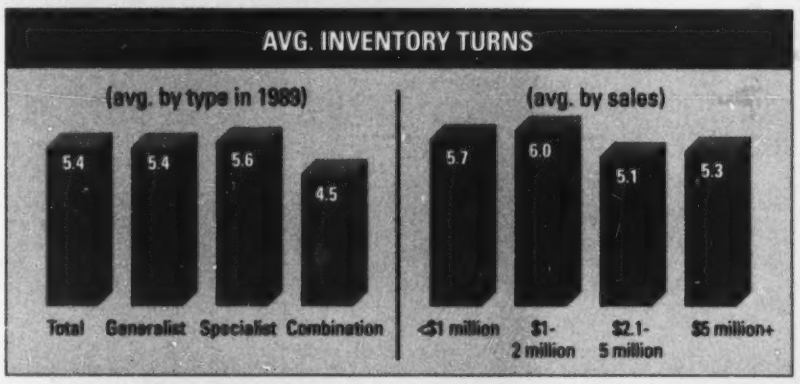


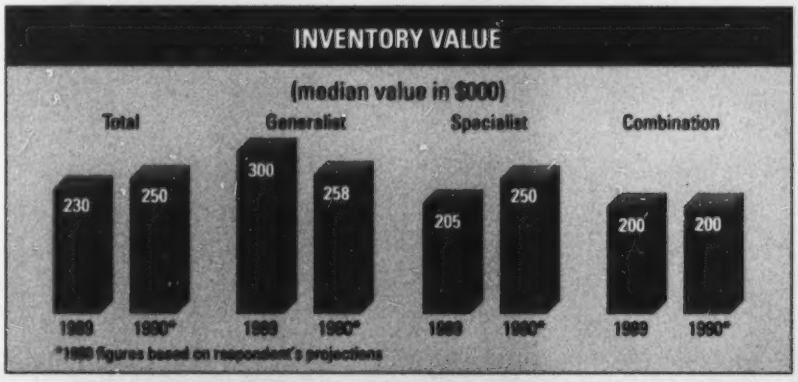
If inventory turns were the sole criteria for measuring a distributorship's efficiency, combination firms would get product in and out of the warehouse fastest, and large distributors would leave little distributors standing humiliated at the loading dock. But such is not the case.

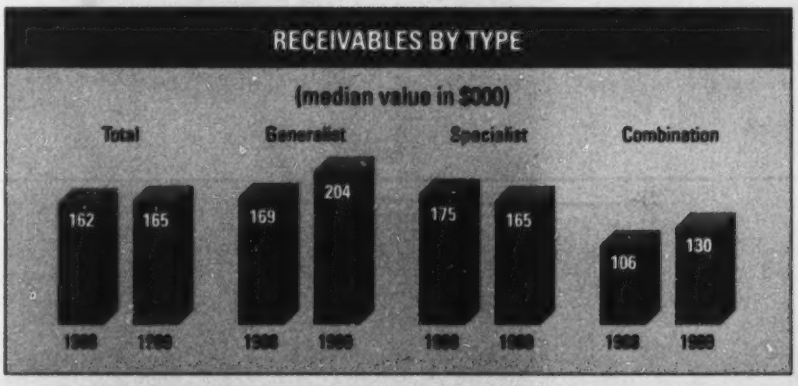
In 1989 industry-wide inventory turns averaged just 5.4 with no significant difference between generalists and specialists. Combination houses under-performed the norm by nearly one whole turn. When measured by sales, again, there was no appreciable difference. In fact, larger distributors, which are generally presumed to move inventory more quickly, failed to distinguish themselves.

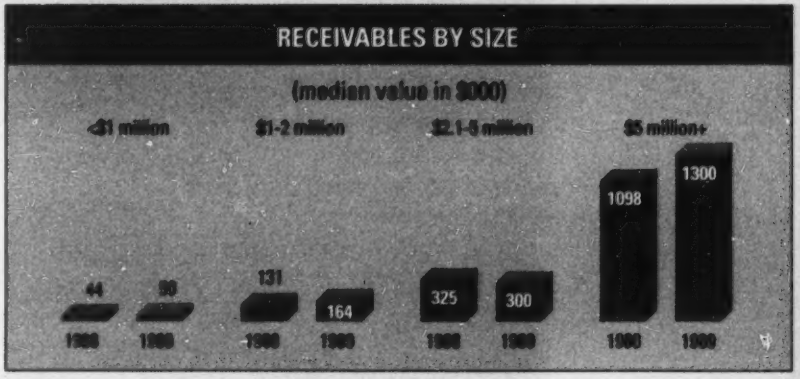
As for inventory value, distributors were asked to project an increase from 1989 to 1990 levels. Should these numbers hold, industrial suppliers expect to increase inventory stocks by nearly 9% from a median value of $230,000 last year to $250,000 in 1989. This increase is expected to come from the specialty houses, who project a 22% increase in inventory value. On the other hand, general line houses expect to reduce their wares some 16%, a sure sign of insecurity for this year's selling season.

Last year, receivables were also on the rise but increased less than 2%. The strongest increase was registered by combination houses (+23%), followed by generalists (+21%), and specialists (+6%). Measured by sales size, the greatest percent increase was posted by those businesses with sales between $1-2 million (+25%); $5+ million (+18%); less than $1 million (14%); and $2.1-5 million (+8%).







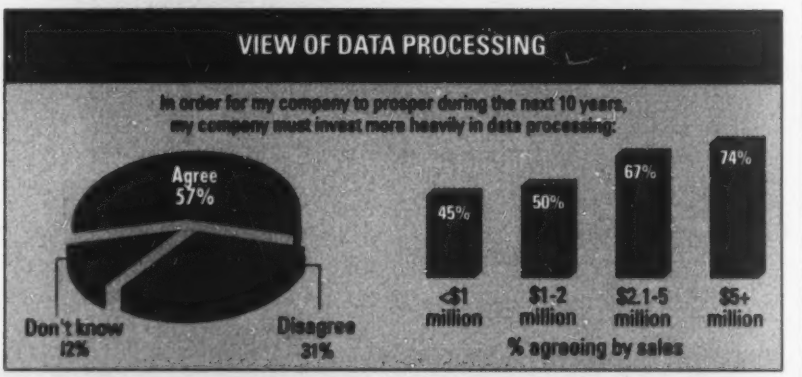


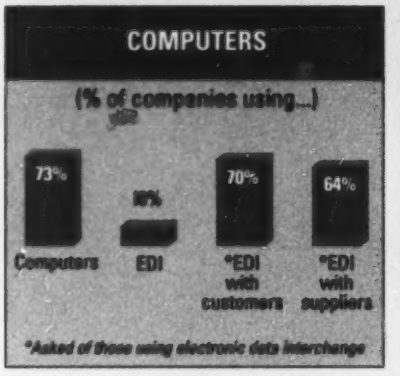
Source: Industrial Distrubition

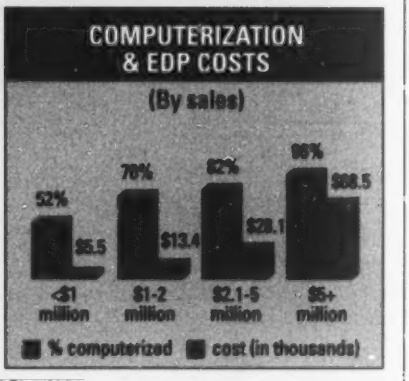
COMPUTERS

Nearly two out of three distributors believe that over the next 10 years, their companies must invest more heavily in data processing in order to remain competitive. That position differs widely, however, when viewed in terms of sales size. While only forty-five percent of distributors with sales of less than $1 million agree with that perspective, 74% of those with sales above $5 million hold that belief.

Little wonder that 96% of the nation's largest distributors are computerized, while barely half of the smallest sized businesses have purchased data processing capabilities. On average, 73% of supply houses are computerized, but relatively few (16%) have ventured into the arena of electronic data interchange. Of those distributors using EDI, 70% are communicating with customers and 64% with their suppliers.



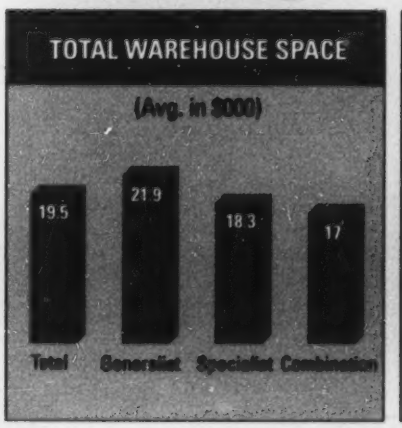


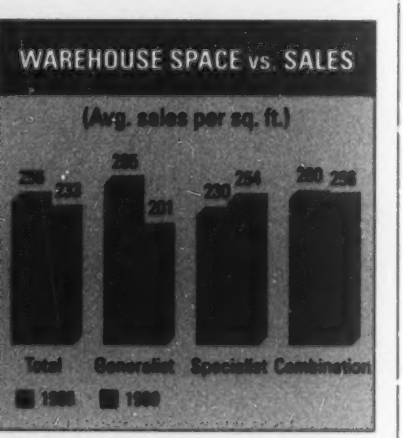


Source: Industrial Distrubition

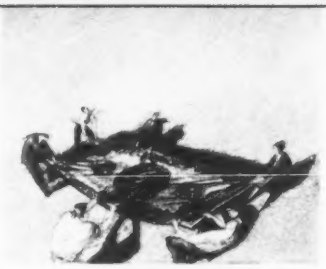
WAREHOUSING

Sales per square foot of warehouse space is by no means an all-inclusive indicator of distributor productivity. It is useful, however, to view the number in the context of wider industry trends. The ratio is simply derived by averaging total warehouse space and dividing it by total sales. What's left is a general indicator of performance for a one year period, not a definitive statement on efficiency. That said, industry-wide sales per square foot declined 10%; generalists (whose sales increased 6.6%) failed to close excess warehouse space and found their ratio collapse some 41%. Specialists used space more efficiently to the tune of 10%, and the ratio for combination houses fell 2%.





Source: Industrial Distrubition



Important Facts About the Survey

Methodology

This year's *Survey of Distributor Operations* is *ID*'s most ambitious effort in 44 years. A six-page questionnaire was inserted in the February issue and mailed to the top executive at each headquarter location on *ID*'s subscription list. The same questionnaire was mailed approximately one month later to the same audience. Nearly 15,000 survey forms were delivered twice, and 831 questionnaires were returned completed, providing a response rate of 5.5%.

For statistical purposes, distributors with annual sales of less than $100,000 during 1989 were eliminated. In addition, one distributor with sales exceeding $300 million was also pulled from the sample to provide a more balanced reading of the data. Responses were received from every state; Washington, D.C., Puerto Rico, the Virgin Islands and Canadian survey forms were eliminated from the base study as the response base was too small to allow interpretation.

Distributor types are defined as follows in the *Survey* and are represented by the following (percent): Generalist (35%)—no one product category contributes 50% or more to total sales; Specialist (50%)—more than 50% of total sales comes from one major product category; Combination House (15%)—sells product to industrial and non-industrial markets while also wholesaling product. Statistical assistance was provided by Cahners Research, which estmates the *Survey*'s margin of error at ±3.5 percent.

Medians & averages

To enhance the value of data in this report, readers will find some numbers expressed as medians, others as averages. Medians define the midpoint in a statistical range—half of any group will be larger than the median, and half smaller. Medians are generally used on open-ended questions, are more representative of a group, and are less distorted by extremes. An average is simply the sum of one group divided by its total number of respondents.

How to order the Survey

The *44th Annual Survey of Distributor Operations* is a 300+ page report containing original statistics on general line, specialty and combination distributors. Operations are measured by type of firm, sales size, and by six geographic regions. Its contents are divided by vital statistics, warehousing, management, sales & profits, operating costs, inventory and receivables, and computers. A single copy is $195 prepaid, $250 if billed. Contact: Diane Mercurio, *ID*, P.O. Box 37, Boston, MA 02258. Or call 617-558-4346.

FINANCIAL SUMMARY

	Total	Generalist	Specialist	Combination	Year Figures	

[illegible] * Percentage of total sales Source: Industrial Distribution